Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the matter of	)	
	)	
Ameritech Operating Companies	)	
Tariff FCC No. 2	)	
Transmittal No. 1312	)	
	)	
Nevada Bell Telephone Companies	)	
Tariff FCC No. 1	)	
Transmittal No. 20	)	
	)	WC Docket No. 02-319
Pacific Bell Telephone Company	)	
FCC Tariff No. 1	)	
Transmittal No. 77	)	
	)	
Southern New England Telephone Companies	)	
Tariff FCC No. 39	)	
Transmittal No. 772	)	
	)	
Southwestern Bell Telephone Company	)	
FCC Tariff No. 73	)	
Transmittal No. 2906	)	

DIRECT CASE OF SBC COMMUNICATIONS INC.

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DIRECT CASE OF SBC COMMUNICATIONS INC.

SBC Communications Inc., on behalf of the Ameritech Operating Companies, Southwestern Bell Telephone Company, Pacific Bell Telephone Company, Nevada Bell Telephone Company and The Southern New England Telephone Company (collectively "SBC"), hereby submits its Direct Case responding to issues set for investigation concerning SBC's proposed revisions to its interstate access tariffs. This Direct Case provides additional evidence that SBC's proposed tariff revisions are just and reasonable and should be permitted to take effect.

I. Introduction and Summary

SBC has fully demonstrated in its tariff and supporting comments that its tariff revisions are warranted, objective and clearly defined, narrowly tailored to address those instances posing the most significant risk of loss to SBC, and fully consistent with established Commission precedent. In the Designation Order,[1] the Pricing Policy Division of the Wireline Competition Bureau raises numerous questions regarding the reasonableness and efficacy of SBC's proposed tariff revisions. In particular, the Designation Order focuses on whether there are changed circumstances that warrant the imposition of additional deposit requirements and, if so, whether SBC's proposed tariff revisions are clear and can be administered in a nondiscriminatory manner.

Recognizing that this likely would be the focus of the Commission's review, SBC discussed at length in both its tariff Description and Justification and Opposition to Petitions to Reject the current financial crisis in the telecommunications industry, with particular emphasis on how the financial downturn in the telecommunications sector has impacted SBC. SBC explained that it has been involved in over 53 bankruptcies in the past two years involving telecommunications entities. SBC further explained that its existing security deposit provisions are inadequate because they fail to protect SBC in instances where a customer with a prompt payment history suddenly ceases to pay its bill two or three months prior to filing for bankruptcy. As a result of this gap in coverage, SBC explained that it currently is owed hundreds of millions of dollars — approximately $420 million — for services rendered, most of which is owed by several of its largest customers. SBC explained that if it is not permitted to respond to the

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[1] *Ameritech Operating Companies Tariff FCC No.2, Transmittal No.1313 et al*, WC Docket No.02-319, Order, DA No. 02-2577 (rel Oct. 10, 2002) (*Designation Order*).

realities of the ongoing industry downturn, which financial experts have predicted will continue, the financial impact to SBC will be devastating.

Such conditions certainly warrant, and in fact compel, SBC to take additional action to protect itself from significant risks of nonpayment. To be sure, SBC, as well as other price-cap LECs, have factored a small level of uncollectibles in their rates. But the point here is that the risk of uncollectibles has increased exponentially over the past two years and there appears to be no end in sight. SBC's rates under price caps and current security deposit provisions do nothing to mitigate SBC's risk of nonpayment from customers posing a significant risk of default, thereby leaving SBC continually exposed to potential revenue losses in the hundreds of millions of dollars. And SBC is not alone. BellSouth, Verizon and small and mid-sized telephone companies are facing similar risk exposure and are seeking to implement additional safeguards. Without additional protection, SBC soon could find itself before the bankruptcy court.

SBC accordingly took action and proposed revisions to its interstate access tariffs. Importantly, in revising and supplementing its security deposit provisions, SBC took into consideration the cash flow concerns of its customers. Rather than seeking a two-month deposit, which SBC can seek today from late payers and would provide SBC the optimal measure of protection, SBC proposed a one-month security deposit and prepayment provision for customers with impaired credit. Rather than applying its impaired credit security provisions to all customers, SBC proposed a $1 million threshold to tailor the provisions to those situations in which SBC is most at risk. And rather than developing credit requirements based on SBC's subjective judgment, SBC proposed objective criteria based on third-party sources to ensure that its tariffs are applied in a nondiscriminatory manner. In addition, SBC proposed to refund any deposit or prepayment within 21 days after a customer demonstrates that the deposit is no longer necessary, thereby ensuring speedy return of such funds and eliminating any potential oversight. SBC therefore has taken steps to ensure that its security deposit provisions are modest, narrowly tailored, objective and applied in reasonable manner.

SBC also proposed clarifications to its existing provisions, such as the definition of "history of late payments," to clear up potential ambiguity and confusion. SBC's intent here is not to impose additional requirements, but rather to provide customers with greater certainty regarding the meaning of tariff terms. In addition, SBC proposed to shorten its bill payment interval for credit-impaired customers and its notice of discontinuance interval. As SBC previously explained, these revisions will enable SBC to act quickly to minimize its losses, and, importantly, will ensure that customers have at least 30 days to make necessary payments prior to any termination of service.

As the foregoing shows, SBC has fully demonstrated the need for and reasonableness of its proposed revisions. Nevertheless, below SBC addresses each issue designated for investigation.

II. ISSUES DESIGNATED FOR INVESTIGATION

A. Deposit Provisions.

The first issue for designation is whether SBC's proposed deposit provisions are reasonable and clear, such that SBC cannot unreasonably discriminate among its interstate access customers. Below, SBC responds to specific questions raised pertaining to that issue.

1. *SBC shall explain why it believes its rates under price caps do not adequately compensate it for the risk of uncollectibles.*

As shown in the table included with SBC's response to question 2 below, SBC's uncollectible amounts embedded in price caps in 1991 were extremely small compared to the current uncollectible trend. The Commission recognized that changes in the overall economy would impact price cap carriers over time. Therefore, at price cap inception, the Commission required that LECs use the Gross National Product Price Index (GNP-PI) as the inflation indicator to modify price cap revenue levels to account for changes in the overall economy.[2] The Commission began using the Gross Domestic Product Price Index (GDP-PI) in 1995 with the same intent in mind, but also to ensure that overseas production was excluded. It is important to note, however, that the GDP-PI reflects only changes in the costs of production that carriers face in light of price changes that occur in all sectors of the economy.

Use of a broad-based index, such as the GDP-PI, significantly understates the impact that major economic changes to the telecommunications sector had on the uncollectibles of LECs. Recent telecommunications bankruptcies have increased the level of carriers' uncollectibles by astounding proportions, as evidenced by the increase in SBC's uncollectible levels during 2000, 2001, and 2002.[3] This increase in uncollectible expense is due not only to the number of telecommunications carrier bankruptcies, but also the size of those bankruptcies. Most notably, World Com and Global Crossing top the list of the largest U.S. bankruptcies of, the past twenty years, ranking 1 and 5 respectively.[4] Because the GDP-PI fails to measure the disproportionately negative state of the telecommunications sector as compared to other sectors of the economy, SBC's rates under price cap do not accurately reflect its risk of uncollectibles.

[2]*Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket 87-313, 5 FCC Rcd 6786 (1990).

[3]SBC's interstate year-to-year change in uncollectibles from 1999 to 2000 and 2000 to 2001 was 45% and 55%, respectively.

[4]*See* BankruptcyData.com (http://www.bankruptcydata.com/Research/15_Largest.htm) (15 largest bankruptcies from 1980-Present).

2. *SBC is directed to submit the level of uncollectible debts from interstate access services for the years 1990 to the present and indicate the level of uncollectibles that was included in its initial price cap rates.*

The following table reflects the level of uncollectibles that SBC included in its initial price cap rates.

Table 1 — *Interstate Uncollectible Amounts Embedded in Rates at Price Cap Inception*

Company	**Amount[5] ('000)**
Ameritech	$9,202
SWBT	$3,805
Pacific	$3,581
Nevada	$78
SNET	$520

The following table reflects interstate uncollectible levels from 1990 to the present, as reported in ARMIS Report 43-01.

Table 2 — *Actual Interstate Uncollectible Levels 1990-Present ('000)*

Year	**Ameritech**	**SWBT**	**Pacific**	**Nevada**	**SNET**
1990	$9,387	$8,102	$4,943	$76	$516
1991	$11,378	$5,376	$3,401	$77	$1,755
1992	$9,794	$5,763	$3,731	$147	$1,688
1993	$11,572	$6,865	$2,857	$111	$933
1994	$16,193	$6,181	$2,566	$98	$867
1995	$7,056	$5,617	$3,196	$82	$603
1996	$15,137	$6,285	$3,755	$103	$1,616
1997	$6,243	$6,811	$5,673	$670	$3,632
1998	$10,997	$7,629	$1,595	$267	$1,273
1999	$4,708	$10,724	$4,640	$195	$1,106
2000	$3,382	$21,738	$4,527	$155	$1,185
2001	$3,573	$35,527	$6,162	$212	$2,558
2002[6]	$105,059	$65,595	$48,225	$201	$8,258

[5]Ameritech Transmittal No. 485, SWBT Transmittal No. 2038, Pacific Transmittal No. 1507, Nevada Transmittal No. 113, and SNET Transmittal No. 521 effective January 1, 1991. The actual uncollectible amounts for the Southwestern Bell and Pacific Bell regions at the time exceeded the amount embedded in interstate access rates at price cap inception.

[6] 2002 Interstate Uncollectible Amounts are YTD through August.

3. *It shall then address whether the variation in uncollectible levels for 2000 and 2001 are merely a normal fluctuation in uncollectibles, which would be covered by the business risks anticipated to be endogenous to prices caps, or whether it reflects some long term trend that warrants expanded deposits from customers meeting SBC's proposed standards.*

The forecast of uncollectibles embedded in price caps more than a decade ago in no way accounts for the current state of the telecommunications industry. First and foremost, the Telecommunications Act of 1996 Act opened previously closed telecommunications markets to competition, which has made the market much more volatile than it was in 1990. This is a significant and permanent change in the market. The dramatic increase in uncollectible levels that SBC has experienced the past two years is one example of this volatility. There can be no serious dispute that the telecommunications industry is in a state of crisis, and many industry experts forecast that the downturn in the telecommunications industry will continue. SBC must be in a position to protect itself from such losses and from the volatility of the highly competitive telecommunications market.

Further, as shown in **Table 2** SBC's uncollectibles have experienced a dramatic and unprecedented increase in the past two years. Between 2000 and 2001, for example, the level of uncollectibles in most of SBC's regions increased 40%, and the level of uncollectibles has more than doubled between 2001 and 2002 YTD. This exponential rise in uncollectibles does not constitute a normal fluctuation, but rather an unprecedented trend in the telecommunications industry. SBC's proposed deposit policy reasonably and effectively mitigates this risk with some modest modifications. The long-term trends that are leading to increased uncollectible expenses are discussed further in response to question 19.

The risk of uncollectibles cannot be addressed solely as a pricing issue. Financial institutions rely on a combination of risk based pricing, diversification, security and reserves to limit losses in credit portfolios. On an individual obligor basis, it is impossible to "price away" credit risk. Other methods of protecting against credit risk are necessary where there is a high degree of industry concentration and industry risk among the customers.

4. *SBC shall provide the Commission with the total amount uncollected by year from January 2000 to July 31, 2002.*

In viewing the figures SBC provides below, it is important that the Commission keep in mind that SBC's booked uncollectible expense in a given year may not equal its actual write-offs for the same period. Consistent with Generally Accepted Accounting Principles (GAAP) and Part 32, SBC matches its expenses with its revenue for a given period. To do so, SBC accrues an uncollectible expense and a "reserve" for uncollectibles, recognizing that SBC will not collect 100% of its billed services 100% of the time. The amount SBC books as uncollectible expense in a given year is based mainly on two factors: 1) the total amount of projected uncollectibles in the current portfolio, and 2) the amount SBC has already reserved for uncollectibles. At any given time, SBC's reserve for uncollectibles should match the projected amount of bad debt that it has in its receivables.[7] The difference between the two is booked as the uncollectible expense.

SBC's actual write-offs for a given period, however, may be higher or lower than its reserve accruals, which are used to determined what SBC books as uncollectible expense. This process is self-correcting. If SBC's actual write-offs vary from prior reserve accruals, the reserve balance becomes over or understated as compared to the projected accounts receivable uncollectibles. As a result, future accruals will be adjusted to "true-up" the original uncollectible expense and reserve accruals to actual write-offs.

[7] The amount needed in reserve can be determined by various methodologies, but generally is arrived at by taking a percentage of the aged receivables (e.g., reserve 100% of receivables over 120 days, 75% of receivables over 90 days, . . . 100% of pre-bankruptcy balances, etc.).

With the foregoing in mind, SBC's total amount booked to uncollectible expense for its wholesale operations (local, interconnection, interstate access services not including the SNET region) for 2000, 2001 and January 2002-July 31, 2002 is as follows:

Table 3 — *Wholesale Uncollectible Expense*

Year	Amount
2000	$20,155,000
2001	$139,443,000
2002 (7/31)	$261,916,000

SBC, however, believes that data regarding the unpaid debt of its bankrupt wholesale customers for this period is most relevant here. The total pre-bankruptcy balances owed by wholesale customers who filed for bankruptcy protection between January 2000 and July 31, 2002 is $460,150,930.35. As discussed further in response to question 16, the pre-bankruptcy balances for carrier customers on an annual basis are as follows: $14,998,060 in 2000, $92,171,174.35 in 2001, and $352,981,696.00 YTD through July 31, 2002.

SBC's total amount booked to uncollectible expense for its retail operations (not including the SNET region) for 2000, 2001 and January 2002-July 31, 2002 is as follows:

Table 4 — *Retail Uncollectible Expense*

Year	Amount
2000	$439,767
2001	$702,932
2002(7/31)	$392,293

These amounts represent a small fraction of SBC's total uncollectible expense.

5. *SBC shall also provide the totals of each of the individual defaults grouped into the following ranges: less than $250,000; $250,001 - $500,000; $500,001 - $1,000,000; $1,000,001 - $5,000,000; more than $5,000,000. For each range, SBC shall indicate the number of defaulting entities.*

While SBC has experienced defaults from customers who did not file for bankruptcy protection, SBC can only accurately group, as requested, the individual defaults of its bankrupt carrier customers. These figures include all balances owed to SBC at the time of the default. In some cases, SBC was able to recover some of these default amounts (see question # 17 below). The number of defaults and the total default dollars by group for these bankrupt carrier customers is as follows:

Table 5 — *Individual Default Groups*

Group	Number	Amount
Less than $250,000	23	$1,455,391.73
$250,001 - $500,000	9	$3,723,481.00
$500,001 - $1,000,000	10	$7,821,767.53
$1,000,001 - $5,000,000	16	$42,662,630.38
More than $5,000,000	14	$404,487,659.71
Total	72	$460,150,930.35

6. *SBC shall also indicate the total dollar amount of deposits it holds that are attributable to interstate access services and the percentage relationship of that amount to average monthly interstate access billings.*

SBC currently is holding deposits totaling just under $1 million, representing much less than 1% of its average monthly interstate access billings.

7. *SBC should accordingly address what modifications should be made in its price cap indexes and service band indexes to account for these changes to the capital and risk parameters of price caps.*

SBC should be permitted to exceed its current price caps to recover the increase in uncollectible expense through an exogenous adjustment. The exogenous calculation would reflect adjustments made to capture uncollectible expenses not embedded in the annual GDP-PI factors applied to price caps. Additionally, the amount of uncollectible levels embedded in price caps would be adjusted to reflect the growth in interstate access services. The latter adjustment would ensure that over recovery does not result from the exogenous filing.

8. *SBC should describe its billing and collection procedures and explain any changes in its billing and collection procedures or the accounting treatment of disputed amounts on bills within the past two years that could have affected the levels of uncollectibles.*

SBC bills for services rendered at the aggregate level, rather than on an individual invoice basis. Thus, a customer purchasing multiple interstate access services from SBC will receive one bill for all of its interstate access services. Customers are given 30 days from the bill date to pay their bills. If payment is not received by the bill due date, i.e. on the 30th day, the account is considered delinquent on the 31^{st} day. Within 10 days after the bill due date (31^{st}- 40^{th} day), SBC will send the customer a letter of refusal of service and discontinuance. The letter will inform the customer that if payment is not received within 30 days from the date of the letter (cut-off date), SBC will initiate refusal of service and disconnection procedures. Three days prior to the cut-off date, SBC will attempt to contact the customer to ensure that payment is received by the cut-off date. On the 31^{st} day, SBC will stop accepting new orders and will place all pending orders on hold pending cancellation. On the 38^{th} day, SBC will begin disconnecting the customer's existing services.

SBC's billing practices and treatment of disputed amounts have not changed over the past two years.

9. *SBC shall indicate the average length of time from the bill date until the bill is sent to the carrier customer and what percentage of those bills, by number of entities and by billed amount, is sent electronically.*

SBC offers customers several options for receiving their bills: CD Rom, electronic, U.S. mail (paper copy), and floppy disk and bill data tape. SBC delivers bills pursuant to its customers' chosen delivery method. The timing for delivery of the bills varies, but SBC renders bills no later than 6 days after the bill date. In any given month, approximately 75% of SBC's carrier customers receive their bills electronically.

10. *SBC shall provide the Commission with the number of customers that have been sent non-payment, discontinuance of service, or refusal of new orders letters in the past year and the average length of time from a bill's being delinquent until the letter was sent.*

SBC has sent refusal and discontinuance of service letters to approximately 60 carrier customers over the past year. The timing for sending out the delinquency notice will vary, but SBC generally sends out such notices within 10 days after the bill payment date.

11. *SBC shall provide the Commission with the percent of carriers' bills disputed, the percent of carrier-billed revenues disputed and the percentage of the disputed amounts that were successfully disputed by the carrier for billing periods beginning with January 2000 to the present.*

Currently, the amount of disputed claims raised by carrier customers is approximately $75 million. This represents a very small percentage of the total amount billed to carriers, as demonstrated by the fact that the most recent monthly billing total for carrier services was close to $500 million ($75 million is the cumulative amount that has been disputed by carriers, which includes billing amounts from many different months). SBC does not routinely track disputed amount information and accordingly cannot provide all of the information requested at this time.

12. *SBC should also indicate if it deducts disputed amounts from amounts billed for purposes of determining whether a carrier has complied with a deadline.*

SBC includes disputed amounts in the amounts billed to a customer for purposes of determining a customer's outstanding balance and late payment charges. If a dispute is resolved in favor of the customer, then the customer's outstanding balance is adjusted and any applicable late payment charges are removed.

13. *SBC shall indicate which services in its interstate access tariff, including the subscriber line charge and other common line services, are billed in advance and those that are billed in arrears.*

SBC's interstate access services that are subject to "usage" charges (i.e., charges billed on a per minute of use) are billed in arrears. All other services are normally billed in advance.

14. *SBC shall indicate the percentage of interstate billings that are billed in advance, how this level has changed over the past five years and how this change has affected the risk SBC faces. In this connection, SBC should discuss whether different deposit provisions should apply depending upon whether the service is billed in advance or billed in arrears.*

The percentage of SBC interstate billings reported in price caps that are billed in advance for the SBC regions are as follows: Ameritech 89%; Nevada Bell 85%; Pacific Bell 87%; SNET 85%; and SWBT 86%. This percentage has not increased significantly over the last three years; however, there was an increase of between 10% and 19% among the SBC regions between 1999 and 2000. This increase was a direct result of the CALLS access reform decision, which implemented a significant reduction in interstate switched access revenues in 1999 that produced a shift in billings from usage-based services to services that are billed in advance.

The recent shift in billings has not minimized the significant risk of uncollectibles facing SBC. The vast majority of SBC's billing is in advance and has been so from SBC's initial offering of interstate access services. SBC's proposed deposit requirements are necessary to enable SBC to mitigate its risk of uncollectibles whether the services are billed in advance or arrears. Moreover, *advance billing does not equate to advance payment*. Today, for advanced billed services, SBC does not receive payment until after the service has been provided. In fact, SBC cannot initiate refusal or disconnection of service procedures until 31 days after a bill payment is late, which equates, at a minimum, to SBC providing a nonpaying customer two-months worth of free service.[8] The risk of providing service without payment is even longer for services billed in arrears.

15. *SBC shall also discuss the extent to which it has a debtor relationship with its customers and how that may affect SBC's credit risk.*

SBC has a debtor relationship with some of its customers who bill SBC for reciprocal compensation. In these situations, SBC's credit risk, at least theoretically, could be partially mitigated if SBC withheld payment of the reciprocal compensation bills to a customer that fails to remit timely payments to SBC. While this situation may be helpful to SBC in select situations, on balance this debtor relationship with the customer is heavily in the favor of the customer, as the amount SBC is billed for reciprocal compensation from its customers is typically less than 10% of the amount SBC bills the same customers for interstate access services.

16. *By year for the period January 2000 to July 31, 2002, SBC should indicate the total amount as well as the net amount owed it by customers it identified as defaulting on access charge payments.*

SBC considers a customer to be in default when a payment is past due. The total past due amounts for interstate access services purchased by carrier customers was $270 million at the

[8] For example, SBC renders a bill on March 1, 2002 for March service (i.e. billing in advance). The bill is due on March 30th. On March 31st, SBC has not received payment so it sends out a letter of refusal of service or disconnection, which demands payment by April 30th. The customer fails to pay by April 30th. SBC can begin disconnection and refusal of service procedures in May. In this example, SBC would have provided the customer two months of service without payment. In reality, SBC will have provided closer to three months of service without payment, because there would be a few days between the bill

end of 2000, $252 million at the end of 2001 and $285 million YTD for 2002. SBC does not track specific offset information, but as noted above, the amount that SBC is billed for reciprocal compensation from its carrier customers is typically less than 10% of the amount SBC bills those same customers for interstate access services. (Please note that past due amounts are distinct from uncollectible expenses, as we explained in response to question 4).

17. *SBC should indicate the amount of unpaid bills of defaulting customers that have gone into bankruptcy since January 2000 and the percentage of that amount that it has recovered through bankruptcy proceedings.*

The vast majority of unpaid bills that SBC has experienced as a result of bankruptcy filings are associated with carrier customers. The table below identifies the total pre-petition balances for carrier customers that filed for bankruptcy protection. The net default amount reflects offsets for reciprocal compensation payments owed to the defaulting carrier.

Table 6 — *Carrier Bankruptcy Defaults*

Year	Gross Default	Net Default
2000	$15 million	
2001	$92 million	$90 million
2002	$353 million	$294 million

Of the $460,150,930.35 in defaults that have resulted from wholesale customer bankruptcies in the past three years, SBC has recovered only $38,142,200.00 or 8.29% of the total through bankruptcy proceedings.

SBC also has been able to obtain some information regarding end user bankruptcy defaults. The table below shows the amount of defaults resulting from large end user bankruptcies by region for 2002. We have not been able to obtain historical data or default data

due date and issuance of the disconnect letter and days between the delinquent payment due date and initiation of disconnection of service.

for bankrupt small and medium businesses, but we expect those amounts are relatively quite small.

Table 7 — *End User 2002 Bankruptcy Defaults*

Region	Default Amount
Ameritech	$986,476.94
Pacific Bell	$375,971.39
SNET	$71,713.35
Southwestern Bell	$716,578.41

SBC has not recovered any of these amounts and did not receive any deposits to offset these default amounts.

18. *SBC should address whether its proposed tariff revisions requiring a deposit or prepayment are consistent with the US Bankruptcy Code and precedents, given that bankruptcy law contains provisions addressing payment to utilities by debtors.*

Under SBC's proposed revisions, a customer will be deemed to have impaired creditworthiness if the customer or its parent commences voluntary receivership or bankruptcy proceedings, which will trigger a one-month deposit or prepayment requirement. This trigger is fully consistent with the US Bankruptcy Code and relevant precedents. Under Section 366(b) of the Bankruptcy Code, a utility is permitted to "alter, refuse, or discontinue service" within 20 days after the bankruptcy order of relief is issued, if the debtor or trustee does not provide "adequate assurance of payment, in the form of a deposit or other security, for service after such date."[9] SBC's bankruptcy trigger does not conflict with this statutory provision; rather it sets forth the amount of "adequate assurance" needed by SBC to continue provisioning service to the debtor, which is fully in line with Section 366(b).

[9] 11 U.S.C. § 366(b).

Bankruptcy courts have held that utilities have the right to initially set the amount for adequate assurance of payment, and further that utilities have the right to the deposit demanded "unless the debtor can show cause to reduce it."[10] While the bankruptcy court certainly is the final arbiter of what constitutes "adequate assurance of payment," nothing precludes utilities such as SBC from establishing tariff terms allowing for the collection of deposits from customers that have filed for bankruptcy.

Moreover, the Commission should take note of the fact that numerous non-dominant carriers in the industry have tariffs in effect that permit them to protect their interests should a customer file for bankruptcy. For example, Section 3 of MCI Worldcom's federal tariff provides that upon a customer's filing for bankruptcy, "the Company may immediately discontinue or suspend service without incurring any liability." Focal and Mpower have similar provisions in their federal tariffs.[11] In addition, Section 4.5.4 of Level 3's federal tariff provides that it may require immediately require a deposit if a customer files for bankruptcy.

19. *If SBC believes that the risk of uncollectible debts has increased permanently, it should explain what accounts for this change, e.g., the general economic climate or some structural change in the market.*

As previously discussed, SBC's risk of uncollectibles has increased permanently with respect to interstate access services. First, the entry of numerous carriers into the telecommunications sector and the increased ability of established carriers to offer new services have increased significantly the level of competition in the telecommunications sector. This competitive pressure directly impacts the revenue growth and expenditures of telecommunications companies, many of which are purchasers of SBC's interstate access

[10] *In re Best Products*, 203 B.R. 51, 54 (E.D. Va. 1996) (citing cases).

[11] *See* Focal Communications Corporation Tariff F.C.C. No. 1 § 3.6.3; Mpower Communications Corp. Tariff F.C.C. No. 1 § 2.11.4.

services. This heightened competition has created and continues to create a cadre of under-performing companies, thereby significantly increasing the volatility of the market and the risk of uncollectibles.

Second, the downturn in the economy, particularly in the telecommunications sector, has significantly weakened customer demand for services. This, in turn, affects carrier revenues and ultimately carriers' ability to pay their debts to SBC. Some analysts have even forecasted a possible deflationary economic scenario, in part, because of the huge increase in capacity over the past decade in sectors like telecommunications and automobiles. At least one analyst forecasts that it will be years before all of the telecommunications capacity that was built up in the 1990s is utilized.[12] Another analyst has stated that in the quarters ahead, 24 of the 29 major publicly traded telecommunications companies may be at risk of bankruptcy.[13] This crisis in the telecommunications industry will have a long-term impact on the ability of customers purchasing interstate access to satisfy their debts. J. P. Morgan Chase, for example, recently announced that it is writing down $1.4 billion in bad loans to telecommunications and cable companies.[1]

Moreover, Moody's reported at the end of 2001 that corporate and bond defaults were the highest since the Great Depression, involving 112 rated issuers and over $135 billion in debt. These amounts dwarf the high levels (112 issuers defaulting on $33.4 billion in debt) that were recorded for 2000. Moody's cited the "rapid expansion of the telecommunications industry was followed by an equally rapid collapse as many firms in the industry failed." Likewise, an S&P study published in August 2002 projected that by the end of 2002, there will be 107 debt issuers that will have fallen from investment grade to speculative grade over a two-year period,

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[12] *How Long Can It Go?* FORTUNE MAGAZINE, at 84 (October 28, 2002).

[13] Scott Cleland of the Precursor Group in a May 20, 2002 research bulletin.

accounting for a record $234 billion in debt. Of a total of $112 billion in debt affected as of mid-year 2002, $48 billion was accounted for by telecommunications companies. The telecommunications industry is overly represented among the large amount of dollar obligations in default and the record number of companies downgraded in the past two years. Thus, the current economic crisis will continue to create a significant risk of non-payment that SBC must address.

20. *If the change is a structural one, are there methods other than the SBC proposal that would adequately address this additional risk, e.g., is there a subset of carriers that can be identified that is the major cause of the increased risk?*

SBC's proposal is the best and most feasible way of providing SBC with some additional measure of protection while taking into consideration the cash flow concerns of its customers. Unlike many other carriers, SBC has proposed a one-month deposit for customers with impaired credit and further has offered customers the option of prepayment in lieu of a deposit. Moreover, SBC's tariff proposal limits its new security deposit provisions to a subset of customers, i.e. those customers meeting the $1 million threshold. By implementing additional safeguards that apply to fewer than 50 end user and carrier customers, SBC will be able to mitigate the risk of non-payment for the vast majority of its interstate access revenues. Thus, SBC's proposal effectively tailors the security deposit provisions to address those instances where SBC faces the most significant risk from uncollectibles.

21. *One alternative would be to phase in deposit requirements over several months after a trigger had been reached. SBC should comment on the efficacy of this alternative and how it might reduce SBC's risk.*

SBC does not consider this a viable alternative for several reasons. First, a phased-in payment approach would not mitigate SBC's risk of significant unpaid debt where a customer

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[14] *Banking on Another Boom*, FORTUNE MAGAZINE, at 48 (October 14, 2002).

defaults shortly after an impaired creditworthiness trigger is reached.[15] As SBC's experience has shown, customers can default shortly after having their credit rating downgraded by a rating agency. There are various reasons for this, not the least of which is a poor cash position by the debtor. Therefore, a one-month deposit or prepayment is insufficient to cover the potential losses SBC will face from impending bankruptcies. Nevertheless, SBC is *seeking* a one-month deposit or prepayment, rather than a two-month deposit, from its credit impaired customers because it believes a one-month deposit would strike a reasonable balance between SBC's need to increase its protection against unpaid debt with the cash flow concerns of financially troubled carriers and other customers. A phased-in deposit would provide SBC with even less protection.

Second, phased-in deposits could trigger the bankruptcy preference laws. All payments that bankrupt debtors make to their creditors within 90 days of the bankruptcy filing are subject to being challenged as preferential payments by the debtor or other creditors, including deposit payments. A phased-in approach for deposit payments would increase the chances that the deposit would have to be returned, thereby undermining SBC's objective here, i.e., to mitigate its risk of significant uncollectibles.

Third, a phased-in deposit requirement would be administratively difficult to monitor for SBC and customers alike.

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[15] It is noteworthy that many companies have loan and bond covenants that require them maintain an investment grade credit rating. Once these companies are downgraded below investment grade they would be technically in default under their loan or bond agreements. Because this generally would entitle the lender to accelerate repayment of the obligation, this in many cases forces the debtor to file for bankruptcy protection to prevent the loan from being called. Thus, while the primary objective of the maneuver may be to fend off a loan default, all creditors are impacted.

22. *SBC shall explain how each of these [impaired credit worthiness] criteria is a valid predictor of whether the customer will pay its interstate access bill.*

There is substantial statistical support for the positive relationship between public credit ratings and probability of default. Studies by Moody's and S&P indicate that the risk of default increases from 4 companies per 1,000 to 100 companies per 1,000 as rated companies fall from investment grade to the lowest speculative grade. This is not at all surprising. As a company's credit condition worsens, its risk of default rises. The company's access to and cost of funds is negatively affected as creditors demand higher interest and impose more stringent terms to continue funding.

This is not a speculative problem for SBC. Over the past two years, the number and dollar amounts of companies downgraded by Moody's and S&P and defaulting on debt has reached record levels. The telecommunications industry accounted for more than 19% of companies with the weakest credit ratings as of mid-year 2002, accounting for $48 billion of a total of $112 billion in debt that has fallen from investment grade to speculative grade. While there are no studies directly relating credit impairment to ability to pay interstate access bills, SBC's experience with uncollectible accounts since 2000, when considered in the context of credit trends in the telecommunications industry, demonstrates that there does appear to be a relationship between deteriorating credit and payment problems

23. *SBC shall also explain how such data can be applied in a manner that will not produce arbitrary and/or discriminatory results.*

SBC has developed objective criteria that rely on established third-party sources to avoid the very concerns raised by this question. All customers satisfying the impaired creditworthiness criteria and $1 million threshold requirement will be required to submit a security deposit or prepayment.

To implement the security deposition tariff provision, SBC will conduct a regular, *i.e.,* at least quarterly, review of the approximately 50 end user and carrier customers that satisfy the $1 million threshold requirement. This frequent review process is possible because of the relatively small number of customers that satisfy the $1 million threshold and because the information that is needed to determine the creditworthiness criteria in SBC's tariff is readily available. While the tariff provides that customers will initiate the refund process in the event their credit or payment condition improves, SBC expects that its review process will help to identify customers who are eligible for a refund. Thus, the $1 million threshold and the objective creditworthiness criteria both help to ensure that the security deposit process is not arbitrary or discriminatory.

24. *SBC shall provide the Commission with information concerning the deposits that it has required of its affiliates.*

SBC has not required deposits from its affiliates. To the extent any of its affiliates satisfies any of the criteria triggering a security deposit, SBC will require a security deposit.

25. *SBC shall also indicate whether any of its affiliates has "impaired credit worthiness" according to the five criteria, and if so, what actions SBC would take in response to that classification.*

None of SBC's affiliates have "impaired creditworthiness" under the criteria set forth in SBC's proposed tariff revisions.

26. *SBC should discuss its intentions, if any, with respect to residential end user customers.*

SBC believes it is highly unlikely that any residential end user would meet the $1 million threshold triggering a security deposit under its impaired creditworthiness criteria. Nevertheless, to the extent any residential end user satisfies any of the criteria triggering a security deposit, the end user will be required to provide SBC a deposit.

27. *SBC should indicate, for each month from January 2001 to present, what percentage of its interstate access customers had bills from "the SBC Telephone Companies" totaling $1 million or more and what percentage of SBC's interstate revenues are attributable to these customers.*

SBC has detailed information regarding the percentage of carrier customers with total interstate access bills totaling $1 million or more for the period August 2001 to September 2002.

Table 8 — *Carrier Customers Above $1 Million Threshold*

Month	% of Customers	% of Revenues
August 2001	3.34%	94.76%
September 2001	3.44%	93.86%
October 2001	3.59%	94.18%
November 2001	3.63%	94.61%
December 2001	3.63%	94.57%
January 2002	3.63%	94.11%
February 2002	3.30%	93.86%
March 2002	3.66%	94.21%
April 2002	3.66%	94.28%
May 2002	3.79%	94.71%
June 2002	3.76%	94.65%
July 2002	3.75%	94.61%
August 2002	3.84%	94.77%
September 2002	3.57%	94.40%

It should be noted that the total number of carriers that satisfy the $1 million threshold for interstate access services is approximately 35.

With respect to end user customers, SBC estimates that no more than 10 such customers satisfy the $1 million threshold for interstate access services. SBC does not have more detailed information regarding the precise percentage of interstate access revenues that are attributable to these customers, but it is relatively small compared to the revenues associated with carrier customers.

28. SBC should also explain how the $1 million threshold is consistent with section 202(a) of the Act.

Section 202(a) of the Act prohibits carriers from engaging in unjust or unreasonable discrimination against any person or class of persons.[16] SBC's proposed $1 million threshold is neither *unjust* nor *unreasonably* discriminatory and, accordingly, is fully consistent with section 202(a) of the Act. Indeed, as we previously explained in response to question 23, the $1 million threshold helps to ensure that the security deposit is applied in a non-discriminatory manner.

Importantly, SBC's proposed $1 million threshold is not restricted to any specific type of customer, but rather is applicable to all customers, *i.e*., CLECs, IXCs and non-carrier customers, that purchase $1 million or more worth of access services per month. While customers that purchase less than $1 million in access services are excluded, this, in and of itself, does not render the limitation unreasonably discriminatory. As the Commission is aware, numerous kinds of tariff provisions apply to certain customers. Volume discounts, for example, are, as a practical matter, only available to certain customers. Tariff limitations, therefore, can apply to certain customers so long as the limitation is reasonable.

And this certainly is the case here. As SBC explained in its Opposition to Petitions to Reject, SBC's existing tariffs offer no protection from carriers who cease paying their bills two or three months prior to declaring bankruptcy and who previously did not have a history of late payment. As a result, SBC has been left holding the bag for several hundred million dollars owed for services rendered, the overwhelming majority of which is owed by SBC's larger customers. In light of this, SBC proposed the $1 million threshold to tailor its "impaired creditworthiness" deposit triggers to only those customers that pose a risk of significant revenue loss to SBC. The $1 million threshold effectively balances SBC's need to protect itself with the

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[16] 47 C.F.R. § 202(a).

financial concerns of its customers. It targets the additional safeguards to the small group of customers that is responsible for generating the vast majority of SBC's interstate access revenues. In this respect, the limit is not only reasonable, but also very much in the public interest, because it reasonably excludes those customers that do not pose a significant risk of revenue loss to SBC.

29. *The proposed tariff revisions would define history of late payments as a failure to pay two monthly bills by the bill due date within a 12-month period of time. SBC should explain how this requirement is indicative of a "proven history of late payments."*

SBC's proposal to define a "proven history of late payments" as a failure to pay timely 2 monthly bills in a 12-month period is reasonable. A failure to pay by the due date twice in a 12-month period is indicative of a pattern of conduct and puts SBC on notice that the customer has difficulty paying its bill timely or at all. Further, the proposed definition of "a proven history of late payments" has been deemed reasonable by state commissions, as evidenced by the fact that this definition is used in SBC's state-approved interconnection agreements.

30. *SBC should explain how it will implement this provision.*

SBC reviews its customers' accounts monthly for unpaid balances and thus will be able to track if a customer has two late payments within a 12-month period.

31. *How are disputed amounts treated for this purpose?*

Disputed amounts are included in a customer's unpaid balance and would be included in SBC's review of a customer's monthly accounts.

32. *SBC should explain why it removed from its tariffs the provision that stated that no deposit will be required of a customer who is a successor of a company that has established credit and has no history of late payments.*

SBC removed this provision in error. SBC will *not* require a customer that is a successor of a company that has established credit and no history of late payments to provide a deposit, unless the company triggers a deposit under the impaired creditworthiness criteria.

33. *SBC shall explain what it means by "total charges" and whether this term includes charges for disputed amounts or services not purchased out [of] its interstate access tariffs (e.g., intrastate services).*

The term "total charges" includes disputed charges, which are part of a customer's unpaid balance. The amount of disputed charges is relatively small.

34. *SBC shall also explain what it means by the term "the SBC Telephone Companies."*

The term "the SBC Telephone Companies" is a shorthand reference to the SBC telephone entities that have interstate access tariffs on file with the Commission, namely the Ameritech Operating Companies, Southwestern Bell Telephone Company, Pacific Bell Telephone Company, Nevada Bell Telephone Company and The Southern New England Telephone Company.

35. *SBC should provide justification for the different interest amounts proposed here. (Interest paid on deposits vs. interest penalty collected for late payments).*

SBC proposes to revise its interest rate paid on deposits to be consistent with the one-year Treasury Bill rate, resulting in the interest rate for security deposits being lower than the interest rate assessed for late payments. As SBC explained in its Opposition to Petitions to Reject, security deposits and late payment charges are different types of assessments that serve different purposes. The purpose of a late payment charge is, not just to compensate the assessor for the time value of money owed, but to also penalize customers who fail to pay their bills on time and to incent them to pay on time. If a late payment charge simply reflected prevailing market interest rates, customers would have no incentive to pay on time because the money they would owe in late payment fees would equal the interest they would have earned while they withheld payment.

Security deposits, on the other hand, operate solely to assure payment from carriers who pose a risk of non-payment. They are not punitive in nature, nor do they serve any deterrent function. Rather, a security deposit is essentially a demand note that a customer has with SBC. If a customer cancels its service, the security deposit must be returned immediately, which means that security deposit funds cannot earn the same return as SBC's commercial paper. Thus, the market rate on a short-term investment, which SBC proposes, is the appropriate interest rate for a security deposit.

36. SBC should explain why prepayments should not be based on a rolling average of the previous month's billing.

Using the most recent month's billing for the prepayment amount, rather than a rolling average, is reflective of the typical amount of services purchased by a customer, and easier to administer for SBC and its customers alike. In SBC's experience, its monthly billings do not radically fluctuate from month-to-month. Therefore, any difference between a customer's most recent monthly billing and a rolling average of its previous month's billing would not prove meaningful. Additionally, calculating a rolling average would be difficult to administer because large amounts of accounting data would have to be maintained in order to carry out this function. Further, such a process invites disputes by customers, who likely would contest the average.

37. SBC shall also explain how it intends to apply the prepayment provisions in a nondiscriminatory manner.

SBC's impaired creditworthiness security deposit provisions gives customers the choice of paying a security deposit or paying for services in advance. All customers subject to the "impaired creditworthiness" criteria will have this option, thereby ensuring that the prepayment provisions are applied in a nondiscriminatory manner.

> 38. *SBC shall provide, for the period January 2000 to present, the Commission with data on the payment characteristics of defaulting interstate access customers during the year prior to the time the account was 90 days overdue. SBC shall present the data in terms that will permit the Commission to identify patterns that may exist in a customer's payment practices prior to default that may permit alternatives to deposits to be identified and evaluated.*

The requested information is extremely difficult to identify and is not available at this time. This is due, in part, to the fact that SBC maintains data based on individual telephone numbers. As a result, a large end user or carrier customer may have several hundred telephone numbers that may be billed on different monthly billing cycles. In order to obtain detailed information about an individual customer's historical payment patterns, SBC would have to perform a manual aggregation of bills for the defaulting customer and examine each bill to determine payment history and when the account became delinquent. To further complicate matters, records that are date back one year or more are archived and thus are not easily accessible. Consequently, SBC is unable to provide the requested information at this time.

> 39. *We ask SBC to provide data, to the extent available, on the level of uncollectibles of other regulated utilities, or in the broader marketplace. It should also discuss the means those businesses use to address the risks of default, especially how they manage bad credit risks while continuing to provide goods or services to the customer.*

SBC generally does not have access to data regarding the level of collectibles of other regulated utilities or their methods of managing bad credit risk. Moreover, the level of uncollectibles and methods used to mitigate risks varies among other regulated utilities. The provisions proposed by SBC are consistent with and in some instances less stringent than policies on record for other public utilities. For example, Southern LNG, a provider of liquefied natural gas, requires deposits "in an amount equal to not more than three estimated maximum monthly bills for services" from customers upon default in payment or who become insolvent.[17] As previously discussed, non-dominant telecommunications carriers also have implemented more stringent security deposit and bankruptcy-related requirements than SBC has proposed.

B. Shortened Notice Period and Bill Payment Interval.

The second issue the Commission has designated for investigation is whether SBC's reduced notice interval for termination of service and 21-day bill payment interval for credit-impaired customers is reasonable. Below, SBC responds to each question posed with regard to this issue and fully demonstrates that the proposed provisions are warranted and reasonable.

1. *SBC shall explain why it believes that the deposit and prepayment provisions it proposes are inadequate and why it needs shortened notice periods as well.*

SBC's proposed deposit and prepayment provisions are sufficient to mitigate its risk only for a very short period of time, i.e., 30 days. The shortened notice periods are necessary to ensure that SBC can take prompt action to minimize its losses to 30 days, or close thereto, of unpaid debt. Without the shortened notice periods, SBC would continue to face the risk of unpaid debt for at least a two-month period.

2. *SBC shall explain why a 21-day deadline for payment of bills is (1) necessary to protect its interest and (2) adequate to allow a customer to evaluate, and dispute if necessary, the accuracy of the charges.*

As SBC has explained, SBC needs to minimize its risk of uncollectibles. A shortened bill payment period will permit SBC to initiate disconnection procedures after 30 days (or close thereto) of unpaid service. Thus, instead of potentially two-months of unpaid debt, SBC would face only one-month of unpaid debt.

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[17] Southern LNG's interstate services are regulated by the Federal Energy Regulatory Commission. Original Tariff Pages 41 and 70 of Southern's Natural Gas Tariff detail the company's policy regarding late paying and insolvent customers (http://www.ferc.gov/gas/gastariffs/index.htm)

A 21-day interval for payment of bills is adequate to allow a customer to evaluate, and dispute, if necessary, the accuracy of the charges. In shortening the bill payment due date for customers with impaired credit, SBC recognized that there often is a time lag between the bill date and the date the customer receives its bill. SBC, accordingly, has proposed that the 21-day cycle for bill payments begin on the date SBC sends or transmits the bill to the customer. This policy will eliminate any time lag between the date the bill is generated and the date it is sent to the customer. For customers that choose electronic delivery, the time lag should be eliminated completely, thereby giving customers the full 21 days to review and pay the bill.

3. *SBC shall explain why a 21-day deadline for payment of deposits (or prepayment) is (1) necessary to protect its interest and (2) adequate to allow a customer to assess SBC's determination that a deposit is required, dispute that determination, and raise the necessary funds.*

SBC needs a 21-day deadline for payment of deposits for the same reasons it needs a 21-day deadline for payment of bills (see SBC's response to question 2).

A 21-day period is sufficient time to permit a customer to assess SBC's determination that a deposit is required. SBC uses objective criteria that the customer can corroborate through third-party sources. Thus, the customer will not have to examine any SBC-specific analysis. Further, because SBC relies on third-party sources to determine if a deposit is required for credit-impaired customers, a customer would have no basis to dispute a determination that a deposit is required. SBC cannot comment on how much time is needed to secure a deposit. Importantly, SBC's deposit provisions provide customers several options for satisfying the deposit requirement, some of which do not require a cash outlay by the customer.

4. *SBC shall also submit information of the most recent twelve months as to the timeliness of its billings. In this connection, it shall state the billing date, the delivery date (indicating whether it was by mail or electronically), and the due date for each billing cycle.*

SBC renders bills to its customers via their chosen method of delivery no later than six days after the bill date. All bills are due 30 days after the bill date unless otherwise specified in SBC's tariff. Approximately 75% of carrier customers receive their bills electronically.

5. *It shall also discuss the appropriateness of prescribing the time with which a bill must be presented to the customer if a shortened notice period were to be allowed, in order to permit the customer sufficient time to review the bill and pursue its dispute rights under the tariff.*

SBC recognizes that there may be a lag between the bill date and the date the bill is sent to the customer. In shortening SBC's bill interval for credit impaired customers, SBC has virtually eliminated the foregoing time lag. As SBC has stated and its tariffs makes clear, the 21-day bill pay cycle would not begin until SBC has sent or electronically transmitted the bill to the customer. Therefore, prescribing a time with which a bill must be presented is unnecessary. Importantly, a customer need only *initiate* a dispute, if any, within the 21-day period. The dispute resolution process does not have to be resolved within the 21-day period.

6. *SBC should address whether it could meet the three-day requirement the Commission adopted in 1987.*

SBC could meet the three-day requirement for customers that elect to receive their bills through electronic transmission. Given that the 21-day bill cycle begins the date SBC actually sends or transmits the bills, SBC anticipates that its customers would receive, even by U.S. mail, its bills within a three-day period.

C. Refund Provisions.

The third issue the Commission designates for investigation is whether SBC's deposit refund provisions are reasonable. Specifically, the Commission asks SBC to explain the following: (1) why SBC should not include provisions in its tariffs requiring it to periodically review accounts to determine if a deposit is still necessary; (2) why SBC should not return a deposit after twelve months of prompt payment; and (3) why SBC needs to retain half the interest accrued on a two-month deposit where SBC returns one-half of a two-month deposit.

SBC's refund provisions provide that it will return deposits and prepayments, with accrued interest, to customers with a history of late payments or impaired creditworthiness within 21 days after the customer demonstrates that it has a prompt payment record or that its credit is no longer impaired. SBC believes it is most reasonable for the customer, rather than SBC, to initiate the refund. Customers are in the best position to determine when their credit or payment conditions have improved. SBC's larger customers tend to be significant players in the telecommunications industry or their respective industries. As such, they have a significant interest in restoring their credit to put themselves in better stead with financial institutions, lenders, and their customers. Indeed, it is customary in financial arrangements for customers to request a review of their credit when conditions causing their credit demise have improved. Further, reliance on the customer to demonstrate that a deposit or prepayment is no longer necessary will prevent any inadvertent omissions or oversight, and ensure that the refunds are issued shortly after the condition triggering the deposit or prepayment is addressed. Importantly, once the customer demonstrates that a deposit is no longer required, SBC will ensure that the refund and any accrued interest is returned within 21 days.

In addition, SBC's tariff provides that where a customer with a history of late payments and impaired creditworthiness demonstrates a prompt payment history, SBC will return half of the two-month deposit, with half of the accrued interest. SBC believes it is reasonable to split the two-month deposit along with the accrued interest in half in instances where half of a two-month deposit is returned. The customer is entitled to receive only a refund of one-month of its two-month deposit and consequently should receive only the interest associated with a one-month deposit. Nevertheless, should the Commission find this policy to be unreasonable, SBC will return half of the deposit and the full interest accrued on the two-month deposit within 21 days after the customer demonstrates a prompt payment history.

D. Application of Revised Deposit Requirements to Term Plan Customers.

The final issue the Commission has designated for investigation is whether SBC's revised deposit revisions constitute a material change to SBC's term plans and, if so, whether it is reasonable to apply the revised provisions to the term plans. The Commission is particularly interested in the following: (1) data regarding the share of interstate access revenues that are received from services subject to term plans and what portion is attributable to services paid in advance, and (2) whether application of the revised deposit requirements is consistent with *RCA Communications, Inc*. SBC addresses these issues below.

SBC's share of interstate access revenues that are received from services subject to term plans by region is as follows: Ameritech 29%, Nevada Bell 3%, Pacific Bell 25%, SNET 15%, Southwestern Bell 29%. Of the foregoing figures, 100% is attributable to services that are paid in advance.

SBC has previously provided, as an attachment to its Opposition to Petitions to Reject, the pertinent pages of its interstate access tariffs, which are representative of all the term plans offered in its service territory. These plans detail the rates, volumes of service, and length of the term plans for interstate access services. They do not reference, or alternatively freeze, any general tariff provisions. SBC's tariff revisions affect only the general tariff sections and, as shown below, do not modify the terms or conditions of any SBC term plan. Accordingly, SBC's existing term plan customers, like any other SBC customer, are fully subject to SBC's general tariff regulations and modifications thereto.

In *RCA American Communications*, the Commission determined that where a carrier proposes to change material terms of a long-term tariff, the carrier must show substantial cause.[18] Under the substantial cause test, the Commission measures the reasonableness of a carrier's proposed changes by considering two factors: (1) the carrier's explanation of the factors necessitating the desired changes at that particular time, and (2) the position of the relying party.[19]

SBC's tariff provisions do not modify any existing term plans and thus do not trigger the substantial cause test. Importantly, SBC's tariff revisions could only modify the terms and conditions of any term plan if the deposit provisions and other pertinent general regulations are set forth, or expressly incorporated, in the term plan. Neither is the case here. As the attached term plans show, the overwhelming majority of SBC's term plans set forth only the pricing plans offered and the terms for service. There is no mention of security deposits or billing provisions, or any reference to the general tariff provisions. Customers under these plans have committed to a certain term period in exchange for a reduced rate for interstate access services and nothing more. Had SBC intended to include the general tariff regulations in its term plans, and restrict its ability to make changes thereto, SBC would have done so expressly. The absence of such language is clear evidence that the general tariff terms have not been "locked" into the term plans. To conclude otherwise would rewrite these term plans.

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[18] *In the Matter of RCA Communications, Inc.*, Revisions to Tariff FCC Nos. 1 and 2, CC Docket No. 80-766, Transmittal Nos. 191 and 273, Memorandum Opinion and Order, 94 F.C.C.2d 1338 (1983).

[19] *Id.*

Several of SBC's term plans, namely Ameritech's and Pacific Bell's Federal Government Specialized Service or Arrangements, do include language stating that the general tariff provisions are applicable to the term plans.[20] However, these tariff provisions in no way "freeze" the general regulations such that SBC is required to make a substantial cause showing before applying any new or revised general regulations to the term plans.

Indeed, SBC's term plans *could not* freeze in place all of the general terms and conditions that apply to SBC's tariffs. If they did, those term plans would not be merely terms plans, but, rather, *contracts* that purported to define and freeze in time all the rights and obligations of the parties. Prior to obtaining pricing flexibility relief from the Commission, SBC could not enter contract tariff offerings.

Even if the Commission concluded incorrectly that SBC's term plans do incorporate and freeze the general tariff provisions, a change in the terms and conditions under which a deposit could be required would not be material. Commission precedent establishes that changes to the following types of provisions in term plans or contract tariffs constitute material changes: (1) rates, (2) termination liability, (3) volume commitments/discounts, (4) length of a service term, (5) grades of service, (6) renewal periods, and (7) elimination of key provisions contained in a term plan.[21] Importantly, customers taking service pursuant to a term plan have committed to purchase service for a specific period of time in exchange for a decrease in price or other favorable conditions. The foregoing types of provisions are critical components of any term plan

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[20] *See, eg.*, Pacific Bell, F.C.C. No. 1, Section 7. Specifically, these term plans include the following language: "In addition to the specific terms and conditions of this Plan described below[following], all other General Regulation for this Plan are contained in Sections 1, 2 and 5, preceding."

[21] *See, e.g.* RCA American Communications, Inc., 86 FCC.2d 1197 (1981); *AT&T Communications Revisions to Tariff F.C.C. No.2, Transmittal Nos. 2404 and 2535*, 5 FCC Rcd 6777 (1990); *AT&T Communications Contract Tariff No.360, Transmittal No. CT 3076*, 11 FCC Rcd 3194 (1995); and *Hi-Tech Furnace Systems, Inc and Robert E. Kornfeld v. Sprint Comm. Co.*, 14 FCC Rcd 8040 (1999).

and factor into a customer's decision to take service pursuant to a term plan, rather than month-to-month service. Thus changes thereto would directly impact the performance, obligations and/or rights of the customer under the term plan. SBC's general regulations, however, are not specific to any term plan, but rather apply to all tariff offerings and customers alike. These regulations are not critical to any customer's decision to take a term plan. Accordingly, changes thereto would not constitute "material" changes invoking the substantial cause test.

Moreover, the Commission, over the years, has declared lawful or permitted to take effect changes to the general regulations of SBC and other ILECs' tariffs without applying the substantial cause test, even though those changes applied to term plans in the tariff. For example, the Commission has permitted SBC and other ILECs to modify their tariffs to establish and later modify charges for universal service, and to apply such charges to term plan customers, without applying the substantial cause test.[22] Further, the Commission has approved or allowed the interest charged for late payments to take effect without a substantial cause showing.[23] Moreover, numerous courts in various jurisdictions have confirmed that revisions to credit terms and finance charges do not constitute "material" changes to a contract.[24] SBC's tariff revisions here are analogous and thus do not warrant application of the substantial cause test.

If the Commission concludes, however, that a substantial cause showing is required, SBC has made such a showing. As discussed above, in determining whether the substantial cause test is satisfied, the Commission must balance the expectations of customers against the business needs of the carrier. SBC's Defense and Justification clearly establishes the business need for its

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[22] *See, e.g.*, SWBT Transmittal No. 2884, filed March 18, 2002, effective April 2, 2002.

[23] *See, e.g.*, SWBT Transmittal No. 2629, issued April 16, 1997, effective May 1, 1997.

tariff revisions. And, as SBC's term plans show, SBC has offered no guarantee that the general terms and conditions of its tariffs would not change. Customers therefore have no reasonable expectation that SBC's general regulations relating to deposits will not change. Indeed, SBC's term plan customers have not challenged other changes to SBC's general terms and conditions, which have been applied to all of SBC's term plans. This confirms that SBC's existing term plan customers have no expectation that those provisions would remain static.

In any event, even if SBC's term plan customers had such an expectation, it would be far outweighed by SBC's need to protect itself from losses in the event a financially impaired carrier fails to pay its bills. As SBC demonstrates herein and demonstrated in its Defense and Justification and Opposition to Petitions to Reject, the state of the economy and the exponential rise in bad debt experienced by SBC renders these tariff provisions a necessity. SBC's revisions represent a reasonable, balanced approach to provide SBC adequate assurance that it will be paid for services rendered to financially troubled firms, without imposing undue burdens on those carriers. There is no basis for exempting term plan customers, some of which are SBC's largest access customers, and which therefore pose the greatest risk to SBC should they fail to pay their bills, from these provisions.

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[24] *See, e.g. Tri-Circle Inc. v. Brugger*, 829 P.2d 540, 18 U.C.C. Rep, Serv.2d (Callaghan) 3785 (Ida. App. 1992); *Rangen v. Valley Trout Farms*, 658 P.2d 955, 35 U.C.C. Rep.Serv. (Callaghan) 1129 (Id. 1983); *Tim Henningan Co., Inc. v. Nunes, Inc.*, 437 A.2d 1355 (R.I. 1981).

III. CONCLUSION

For the foregoing reasons, the Commission should find that SBC's proposed security deposit and interval provisions are reasonable and permit SBC's tariffs to take effect.

Respectfully Submitted,

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